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DISCUSSION PAPER No. 6

AN APPROACH TO UNDERSTANDING  
ORGANIZATIONAL STRUCTURE  
IN THE AUDITED ENTITY

BY

Martin Griffith Evans

MAY 1982

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# **AN APPROACH TO UNDERSTANDING ORGANIZATIONAL STRUCTURE IN THE AUDITED ENTITY**

by

**Martin Griffith Evans**

This approach to understanding the organizational structure of audited entities has been developed for the following purposes:


- to identify the critical elements of the organizational structure, the internal systems (control, motivation, and reward) and the external environment;
- to identify inconsistencies between these three elements; and
- to recommend changes in these systems to: (a) reduce inconsistencies and (b) increase economy, efficiency and effectiveness.

## **The Organization**

### **Organization Goals**

These can be identified by an examination of:

- (a) the parliamentary mandate given to the organization through legislation;



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- (b) supplementary government regulations promulgated through Order in Council; and
- (c) documents from the organization itself on its mandate.

A first analysis can be made of the consistency between these three types of goal documentation. Inconsistencies between (a) and either (b) or (c) would suggest that the organization is not fulfilling its parliamentary mandate.

### **Types of Goals**

These analyses will usually identify two types of organizational goals:

**Goals concerning the operation of particular programs.** For example, Customs and Excise is involved in the collection of import duties and excise taxes. It is not concerned with the development of policies as to: (i) what should be taxed; (ii) what type of tax should be imposed, e.g., VAT, or sales tax; or (iii) what level or rate of tax should be imposed. These policies are the responsibility of Finance, though Customs and Excise may (and should) be called upon to comment on the feasibility and cost effectiveness of programs proposed by National Revenue. Thus, we might call departments such as Customs and Excise operating departments.

**Goals concerning the development of policy initiatives.** An example here might be the Privy Council Office, whose sole purpose is to develop



interdepartmental policy initiatives. It has few programs of its own to administer. Such organizations might be termed policy development departments.

Of course, many departments (such as Indian Affairs) will have both types of goals -- policy development and program administration. In such cases, the auditor must make judgements about:

- (a) the relative importance of each type of goal;
- (b) the kinds of organizational structures used in the attainment of each type of goal;
- (c) the level of resource allocation to each goal; and ultimately
- (d) the economy, effectiveness and efficiency with which each goal is attained.

## **Organizational Structure<sup>1</sup>**

Each organization can conveniently be divided into five parts, categorized as follows. These in turn may have finer subdivisions.

**The strategic apex.** This consists of the top management group of the organization. These people are "charged with ensuring that the organization serve(s) its mission in an effective way" and that it (the strategic apex) sets appropriate





goals for the organization to meet the opportunities and constraints provided by the environment of the organization. To fulfill this mandate requires three tasks:

- (i) the direct supervision of others in the organization;
- (ii) liaison with elements of the environment for data gathering, lobbying, and coalition building; and
- (iii) development of the organization's strategy -- this involves the identification of threats and opportunities in the environment and the development of programs to deal with these.

**The operating core.** This grouping includes all those organization members who perform the basic work directly related to the production of goods and services. These are the people who execute the programs of the department: the postmen, Indian agents, tax inspectors, and so on.

**The middle line.** This provides direct supervision and co-ordination of individuals, groups and sections. Its existence is predicated on the assumption that these tasks require close contact between the co-ordinator and the groups being co-ordinated. Thus the middle line links the strategic apex with the operating core and makes sure that the strategies developed at the top are translated into operational activities and that these activities are performed and co-ordinated. The tasks involve:

- direct supervision of subordinates;





- downward resource allocation;
- upward performance feedback;
- upward requests for changes, ideas about new programs, information about potential effects of new programs; and
- decision-making within the scope delegated to him/her by (i) the strategic apex and (ii) those above him/her in the middle line.

Generally, as one descends the line the scope becomes more restricted, the consequences of decisions have a shorter time frame, and the issues dealt with are more concrete. However, agencies or departments may differ in the extent to which broader decision-making power is delegated down the middle line; in addition, they may differ in the extent to which the premises of delegated decisions are specified in written standard operating procedures. It is useful to see centralization of decision-making and standardization of operating procedures as alternative forms of achieving control in a department. Departments with both a high level of decision centralization and a formidable set of rules and regulations are probably over-controlled. A more appropriate mix would be to centralize policy-making and to use it to set the standard premises for operational decisions, which can then be delegated to lower levels in the department.

**The technostructure.** This grouping of activities serves three control functions:



- (i) The development of standard operating procedures to guide:
  - (a) the activities of the members of the operating core; and
  - (b) the activities and decisions of the middle line.
- (ii) The development of plans and budgets for controlling the activities of the operating core and middle line by specifying the outputs they must provide -- for example, (a) developing the criteria against which economy, efficiency and effectiveness are to be judged, and (b) developing procedures for getting the information so that those judgements can be made.
- (iii) Developing training programs for the control of activities through the development of skills and the inculcation of standards for behaviour for the members of the operating core and the middle line.

It also serves the following strategic function as an adjunct to the strategic apex:

- (iv) The development of alternative courses of action for the organization to take, based on:
  - (a) strategic information from the apex, and





(b) their own scanning of various parts of the environment.

**The support staff.** In this grouping are a variety of organizational units that provide housekeeping services for the organization. These groups are only loosely linked to the operating core and provide an alternative to the organization's contracting these services out -- services such as legal advice, cafeteria, payroll administration, public relations, and so on. However, the distinction between this group and the technostructure lies not in this make-versus-buy criterion, but in the nature of the service. They, unlike the technostructure, do not provide standardization techniques to the operating core or middle line; they do provide services that are required by the middle line and operating core. They do not provide strategic advice, although they may be on tap for specialist advice.

### **Implications of these Structural Elements for the Audit**

Organizations with different missions, and organizations with different characteristics in terms of size, differences in services offered and technology will differ in: (a) the size, (b) the power and (c) the inter-relations of these five structural elements.

### **Impact of Organizational Mission**

In departments where the primary goal is program operation, one would expect to find that the strategic apex was small or relatively unimportant, that the technostructure's main tasks were related to the design and development of





new operating procedures, and that most of the organization's resources were committed to the operating core.

On the other hand, in departments whose prime goal is program development, one would find an important (and large) strategic apex, a technostructure with tasks focused on scanning the environment and developing alternative courses of action, and a small operating core.

Finally, in departments with both these goals, we would find a large strategic apex, a large technostructure with the dual mission of control and environment scanning (perhaps with these activities performed by different sub-units) and a large commitment of resources to the operating core.

It is important for the auditor in this initial examination to judge whether or not the global structure of the organization -- in terms of resource commitment -- fits the mission(s) of the organization. In other words, the auditor should assess whether the balance of size and importance of these structural components is consistent with the balance of organizational goals.

## **Impact of Task Environment and Size on Organizational Structure<sup>2</sup>**

### **The Environment**

For any organization, the environment consists of the set of organizations and people outside the department under scrutiny. Of course, in any diagnosis,



we are in the main concerned about environmental units with which the department is in direct contact. However, the influence of indirect contact (i.e., general rules made by another department) should not be overlooked.

There are three questions to be asked about the environment of an organization. Having identified the questions, the structural implications of the answers to these questions will be discussed.

1. Is the environment homogeneous? That is, does the organization offer its services to a narrow range of clients (people or other organizations) or is it offering a wide range of different services to a wide range of clients? Looking at the Government of Canada as a whole, clearly its environment is very heterogeneous. The solution has been to departmentalize by client groups -- labour; manpower and immigration; industry, trade and commerce; Indian affairs; etc. Thus the environment of each department is more homogeneous than the environment of the government alone. Nevertheless, the environments of individual departments may differ in the degree of homogeneity.

What to ask:

- How many other organization/clients does the department have contact with?





- Do these make similar or different types of demands on the department?
  - Do these different environmental clients have different powers vis-à-vis the departments? That is, should one, in practice, focus on meeting one set of demands only?
2. Can the environment be segmented into homogeneous sub-groupings? Even if an environment is relatively non-homogeneous, it is sometimes possible to classify organizations or people into different types and provide organizational sub-units to deal with each type. In other cases, the demands from different groups in the environment are inter-dependent so that it is not possible to segment the environment, and the whole organization will have to deal with all environmental sectors.
3. Is the environment simple and stable or it is complex and changing? When the environment is simple and stable, the information required to make decisions is at a minimum. Thus decisions can be arrived at by one or two people at the summit of the organization, and the ability to do this can be enhanced by the establishment of rules and procedures as a basis for decision-making at the lowest levels in the organization. On the other hand, when the environment is complex and changing: (a) the information requirements to make decisions are high, so many people need to be involved in gathering information and in making the decisions, and (b) the



establishment of rules and procedures is often counterproductive because the situation faced at any one time is unique, so that the precedents embodied in these formal rules and procedures are no longer appropriate.

What to ask:

- How sure is the department of the consequences of the action it takes?
- How long does it take for the department to get feedback on the consequences of its actions?
- How stable are the demands made by the environment or how predictable are the changes in demands?
- To what extent are the demands made by the same environmental sector?
- How do the demands made by different sectors in the environment interact in terms of the total demand made on the department?
- Do different groups make conflicting demands on the department?





## Structural Implications for Different Environmental Characteristics

**Homogeneous, simple and stable environments.** In such a situation, the most appropriate organization form would have:

- (a) A strategic apex whose main role would be managing by exception;
- (b) A single middle line connecting it to (c);
- (c) A single operating core;
- (d) A technostructure that would spend little time in scanning the environment and developing new, alternative course of action. Rather, its focus would be on developing standard rules and regulations and associated measures of preference;
- (e) The support service department, which would perform the usual auxiliary functions.

Additionally, in such organizations the work would be finely specialized and decision-making would be concentrated at the top of the organization.

**Heterogeneous, simple and stable environments.** In such a situation, the appropriate structure would be very similar to the preceding one, except that there would be several operating cores, each of which would interface with its own elements and would be joined to the strategic apex by a separate middle line.



Each middle line and operating core might have some technostucture units attached which had developed idiosyncratic standards and procedures for each unit -- this should be the case where heterogeneity is high and similar procedures and standards would be inappropriate for the whole organization. In addition, some technostucture units, especially those involved in scanning the environment and planning future activities, might be directly attached to the strategic apex. The service functions would be common across the organization.

**Homogeneous, complex and changing environments.** In this kind of situation, two things are clear. First, there is too much information for a single individual to comprehend; decision-making must therefore be delegated. Second, because the situation is changing, the development of many standard procedures would be inappropriate. In this situation, the appropriate structure would have:

- (a) A strategic apex whose major focus is scanning and liaison with the environment;
- (b) A single operating core joined to the strategic apex by (c);
- (c) A single middle line;
- (d) A moderately sized technostucture whose role would involve a large amount of effort placed in environment scanning in order to provide input to the strategic apex for changing programs or services in light of changes in the environment. There would be little work done on the development of standard rules and



procedures; however, some work would be done on developing selection and training procedures (see below);

- (e) Finally, the usual support staff groups would exist.

The major problem in such an organization is the maintenance of control. This cannot be achieved through standard rules and procedures, nor can it be achieved through centralized decision-making. Therefore, control must reside within the members of the operating core and middle line themselves. This means that the selection and training of people who are skilled in the necessary tasks and have committed themselves to the goals of the organization is essential. Appropriate procedures would be developed by the members of the technostructure. A good example of such an organization would be the Department of External Affairs.

**Heterogeneous, complex and changing environments.** In this case, the complexity of demands from different clients implies that it is not easy to segment the organization into different groups with their own middle line and operating cores (and technostructures). In this situation, the appropriate organization form is quite different from the previous form.

- (a) The strategic apex and the scanning and planning portions of the technostructure are highly developed, and the focus of activities is external liaison, scanning of changes, and planning new programs for the organization.





- (b) The middle line is probably non-existent as a hierarchy, but merges with the technostructure and support staff.
- (c) The technostructure and operating core are organized on a project (or matrix) line so that task forces of planning, design and operation come together to deal with temporary environmental demands.
- (d) The support services are provided on an organization-wide basis. Once again, in this situation, control is exercised through the people themselves so that appropriate selection and training are critical.



### FOOTNOTES

1. This section is based on the work of Henry Mintzberg, The Structuring of Organizations, Prentice Hall, 1979.
2. In addition to Mintzberg's work, this section draws on three sources:

Lorsch, J.W. Introduction to the structural design of organizations. In Dalton G., Lawrence, P., and Lorsch, J. Organization Structure and Design, Irwin-Dorsey, 1970.

Nadler, D.A. and Tushman, M.L. A diagnostic model for organizational behavior. In Hackman, J.R., Lawler, E.E., and Porter, L.M., Perspective on Behavior in Organizations, McGraw-Hill, 1977.

Duncan, R. A decision tree approach to organizational design. Organizational Dynamics, 1979.





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